

Good Afternoon Members of the Congress & Distinguished Guests,

My name is Stuart Sokel and I am a Director at Deutsche Bank in New York City. Having spent the last 14 years in the oil trading industry, my testimony today will attempt to provide insight into the logistical and economic forces that are currently in place today.

Without a doubt, high energy prices are having a major impact on the nation's economy and it is imperative to understand the core issues which are significantly affecting the US Commercial Airline Industry. I invite questions & comments at any point should further clarity be required.

In brief, the oil market today reflects a composite view of global macroeconomic strength, environmental concerns and demographic changes all of which have contributed to dramatically higher energy prices over the past year. Most Americans are keenly aware of how limited refinery capacity in the United States, a point that has been pronounced due to the damage wrought by the hurricanes in the gulf coast region, has meant higher refined product prices.

This point, however, only gives a partial explanation and needs greater scrutiny. To start, let's remember what has taken place in the world since 1998. At precisely the same time that a number of emerging market countries, including India & Thailand, were rapidly expanding domestic refinery capacity, a financial crisis in Asia coupled with overcapacity from OPEC pushed oil prices to levels that seem like a mere memory today. 10\$ oil was just another session away and many respected journals and pundits predicted the end of reliance on oil, middle eastern or otherwise.

In retrospect, this period was a mere blip on the trendline of growth that has taken place in the world today. Today, the major US Airlines are competing for the same barrel of jet fuel that Singapore Airlines, Qantas and British Airways need for their own fleet. Seven years ago, domestic passenger demand in India and China alone was a mere pittance compared to today. In addition, the environmental regulations of a lower sulphur gasoline and diesel fuel in Europe and the United States have only served to take the jet fuel market into further deficit given the continuing difficulty of refiners to adapt to changes in product specification. In short, the situation would appear to be dire and it becomes critical to develop a strategy that serves the industry in the coming years whilst addressing the immediate need to remain solvent.

To start, we have to acknowledge that the lack of investment in refinery and terminal capacity over the past 30 years will not likely suffice for the next 30 years. To be critical of the oil industry, however, neglects a very important point. The logistical hurdles of building a new refinery coupled with the questionable return on investment given historically poor margins did not exactly provide the integrated companies with any major incentives.

This point may be small consolation for the Aviation Industry but it does provide a bit of historical context to the current dilemma. In order to remedy the supply

bottlenecks, the coastal areas of the United States will need investment in the downstream sector and will also need support from the Congress in order to educate an electorate which seems comfortable with the notion of affordable oil as long as the infrastructure is not in their back yard. Storage facilities need to be in close proximity to high volume airports and major markets. Such projects will need to be environmentally and economically sound but without a reasonable commitment from all interested parties, the burden of supplying jet fuel will fall exclusively into the hands of market forces which will lead to a continuation of high prices in years ahead.

Management of energy risk is an area that many carriers have neglected in recent years and unfortunately, the blame may be spread around in no short order. Most of the airlines which did hedge for the current fiscal year have not hedged their exposure for 2006 and beyond. In addition, a large percentage of the hedges were placed in crude oil as opposed to their actual exposure which is jet fuel. In trading jargon, this differential is commonly referred to as basis risk given the potential for jet fuel to outpace the rise in crude oil prices. In effect, that is precisely what has happened this year and the market expectation is that this will continue.

For airlines that did not hedge, or for those which liquidated hedges due to court ordered instruction, the outlook remains very severe given the current forward price of approximately 2.00/gallon for 2006. It is fair to say that Wall Street can be critical of hedging activity which is unprofitable, as exemplified by certain refiner activity. However, the incremental cost of fuel and labor will continue to play the largest role in the future outcome of the industry. Whilst, labor costs cannot be hedged, oil prices certainly can be managed in the same manner in which companies monitor their foreign exchange, interest rate and credit exposure.

There is an adage in financial markets which states that the only thing that can cure high prices is high prices. The airline industry, however, suffers from the burden of having to pay high prices without the flexibility of receiving higher fares. Historically, carriers have been loathe to pass on higher fuel costs in the form of any additional tariff for fear of being undercut by the competition. This has lead to a vicious cycle within the industry, an important matter left for an airline industry expert to discuss as opposed to an oil trader. From my perspective, however, the potential solutions aforementioned are sound and will allow the forces of supply and demand to act to the advantage of the consumer and industry alike.

Thank you.